



DEAN F. ANDAL
Member, Board of Equalization

Agriculture Update

Single-use temperature recorder deemed tax exempt

A January Board decision finally brought closure to an important issue that went unresolved for years.

The decision involves the appeal of Ms. Susan Lorie Caslin (Tylock), President and owner of Caslin

Distributing. The issue in the Caslin case was whether sales of single-use temperature recorders placed in refrigerated

... the Board directed staff to publish this opinion - thereby solving this tax problem for all similarly situated taxpayers.

carriers shipping perishable products were: a) taxable sales, b) nontaxable sales for resale, or c) exempt sales in interstate commerce.

Ms. Caslin's business was audited for the period from March 1990 to December 1993. In early 1994, the auditor held her sales were taxable and assessed her for the liability (an amount which would

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Recent Legislation

Last year, Senator Dick Monteith introduced Senate Bill 1974 to extend the sales tax exemption for seeds and annual plants that produce food for human consumption to *all* food-bearing plants and trees. These provisions were subsequently included in a budget bill relating to taxation (Assembly Bill 2798 – Chapter 323, Statutes of 1998) and became effective January 1, 1999.

Prior to enactment of these provisions, the law was illogical: for purposes of taxation, it allowed different treatment of annual and non-annual plants. In changing the law,

the legislature clearly saw it was a matter of equity to extend the exemption to *any* seed, plant, or tree that is used to produce food for human consumption.

To implement this legislation, the Board of Equalization adopted (and the Office of Administrative Law approved) Regulation 1588 to further clarify that grape rootstock are included and are, therefore, exempt from taxation. This regulation became effective March 2, 1999.

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Non-taxable fertilizer win for the taxpayer

Chalk up another win for the taxpayer! Here are the facts in this interesting case:

In *Leonard Eugene Perry v. State Board of Equalization*, Mr. Leonard Perry petitioned for redetermination under current tax law. Mr. Perry supplies biological products and services to the dairy industry. The question at hand in his petition for redetermination was whether certain additives applied by Mr. Perry to dairy farmers' lagoons were excluded from tax because they met the definition of a "nontaxable fertilizer" under current law.

These specific additives – lagoon inoculants – are substances used to break down solids and improve the fertilizer quality of manure. Mr. Perry applies these inoculants to the wastewater held in his clients' lagoons. After treatment, the wastewater is drained off and used to irrigate fields. Any solid matter left at the bottom of the lagoon (after drainage) is dried and used by the farmers as fertilizer for their fields.

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Board approves regulatory changes

July 29, 1999, was a good day for agriculture at the State Board of Equalization. Three regulatory changes were approved to accomplish the following:

Regulation 1587: *Animal Life, Feed, Drugs & Medicines.*

➔ Provides that tax does not apply to cellulose casings used to manufacture processed meat products which are ultimately resold as, or incorporated into, feed for animals sold in the regular course of business.

➔ This amendment is a significant victory for the California poultry industry which sought to correct a competitive disadvantage faced by the industry: 48 of the 50 states do not impose a tax on cellulose casings because they are not considered a "manufacturing aid." Current technology allows re-use of the sausage casings to create an end product: animal feed.

Regulation 1589: *Containers and Labels.*

➔ Specifies instances when a container used for shipment or delivery of food for human consumption is not customarily returned by the buyer. If a container meets the criteria established in the revised provision, the container is a non-returnable container and tax will not apply. The amendments explain that a container is not customarily returned by the buyer when:

- 1) The container is sold together with the contents.
- 2) No deposit is charged on the container.
- 3) Title to the container is not retained.
- 4) There is no obligation to repurchase the container.
- 5) The container is of the type that is fungible.
- 6) The container is repurchased

without regard to whether it is the same container originally sold.

7) The repurchaser of the container is in an industry that includes at least three participants.

➔ Clarifies the existing application of tax to leased returnable containers. The regulation was amended to provide that in the case of a lease of a returnable container that is a continuing sale, the lessor's first lease of the container for filling is taxable for the full term of the lease or thirty (30) days, whichever is greater and that any subsequent lease of the container for refilling is not subject to tax.

Regulation 1630: *Packers, Loaders & Shippers.*

➔ Clarifies that items purchased and physically incorporated into the product being sold can be purchased for resale (tax-exempt.)

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Assessor's Handbook Re-Write

Several areas of the property tax assessors' handbook section, "assessment of Agricultural and Open Space Properties," became the subject of significant debate at the State Board of Equalization in recent years. Two ag-friendly revisions of particular interest are noted below:

Increased Risk Rate

The California Land Conservation Act, also known as the Williamson Act, encourages the preservation, conservation and continued existence of agricultural and open space land through reduced property taxation.

While the intent of this Act is to lessen the tax burden on farmland, the Board of Equalization provided guidelines to local assessors that, in some instances, did just the opposite. The guidelines recommended calculating a particular component of the capitalization rate (the "risk rate" component) in such a way that caused many landowners to actually lose the benefits provided by the Williamson Act.

In fact, if one used the Proposition 13 formulas, the values of some restricted properties were often less than the values calculated under the Williamson Act.

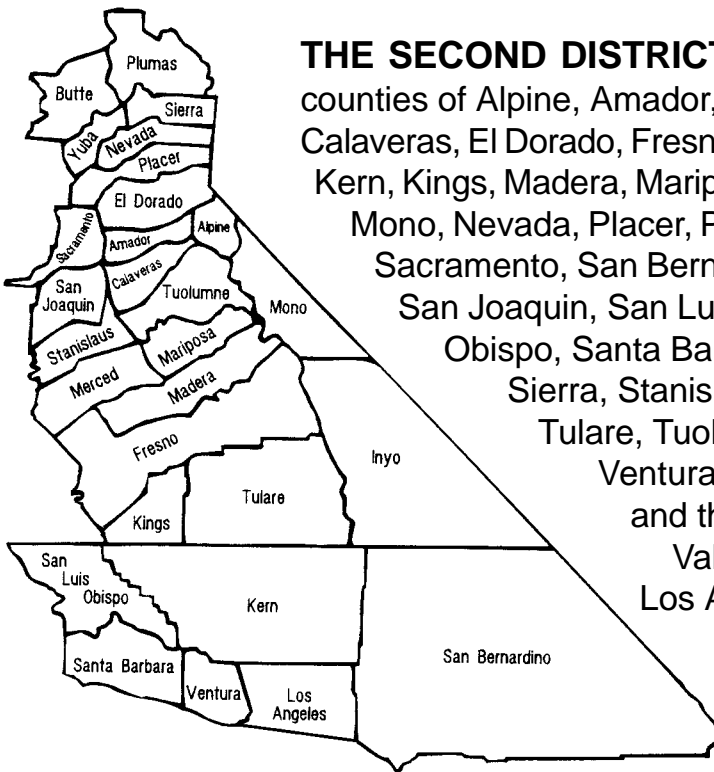
Aware of the unjust tax burden being faced by farmers, the Board of Equalization directed staff to revise the

Assessor's Handbook to provide for a higher minimum risk rate (1%) in order to preserve property tax benefits provided in the Williamson Act.

Improved Definition of "Highest & Best Use"

Some county assessors were also valuing agricultural land by looking at uses that were different than the present use. This is known as the "highest and best use" method of valuing property and tends to yield higher values for the land and, therefore, higher taxation. Practices such as

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THE SECOND DISTRICT includes counties of Alpine, Amador, Butte, Calaveras, El Dorado, Fresno, Inyo, Kern, Kings, Madera, Mariposa, Merced, Mono, Nevada, Placer, Plumas, Sacramento, San Bernardino, San Joaquin, San Luis Obispo, Santa Barbara, Sierra, Stanislaus, Tulare, Tuolumne, Ventura, Yuba and the Antelope Valley portion of Los Angeles County.

LEGISLATION

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Senate Bill 963, authored by Senator Monteith provides a sales and use tax exemption for pharmaceuticals, including oxygen, that are administered to animal life which ordinarily constitute food for human consumption.

The Senator introduced the bill to correct an inequity and to support aquaculture ("fish farming") which is a fast emerging sector of the agriculture industry in California. While federal law exempts oxygen pumped into high density fish tanks, the State Board of Equalization legal staff has opined that state law requires sales tax to be collected on purchases of oxygen used in fish farming.

Recently the Governor agreed that oxygen should be added to the list of other tax-exempt products used to produce food and signed the bill into law (Chapter 289, Statutes of 1999.)

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Examples: wax and fungicide, post harvest protective shields, protective coatings, salts, acids and caustics.

➔ Also provides that preservative products that remain in the packaged food product until opened by the consumer, or are included in the shipping containers of exempt food products, are part of the containers and thus are tax-exempt.

Examples: moisture-absorbing desiccants, gas absorbing ethylene sachets, gas emitting sulfur dioxide pads, and nitrogen gas.

➔ The California Grape & Fruit Tree League was a strong advocate for these amendments.

WIN

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Board of Equalization staff concluded that Mr. Perry was liable for use tax because he used the inoculants as part of his business providing a service to the farmers.

Based on testimony from an expert in plant pathology, the Board concluded that these products, due to their chemical composition (mineral content) fall within the definition of "commercial fertilizer" under the Food & Agriculture Code (Section 14522) and, as such, are not taxable.

Mr. Perry's petition for redetermination was granted and the case was published to ensure that others similarly situated won't be erroneously taxed.

HANDBOOK

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this were formidable obstacles in achieving the goals of the Williamson Act.

Here is an example to demonstrate this controversy: a brussel sprout grower had his restricted land valued on the basis of what his yield would have been if he had grown strawberries. Because strawberries yield more income than brussel sprouts, his land was valued higher than what was fair and reasonable.

Again seeing the inequity, the Board of Equalization revised the Assessor's Handbook to include definitions to make the appraisal of open space land less subjective and to provide factors that must be considered when determining whether to value open space land at other than its present use.

TAX

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have put her out of business). Therefore, she appealed the auditor's findings on several grounds and, for the next four years, found herself in various stages of the administrative appeals process until the Board's decision in January of this year.

For background, the recorders Ms. Caslin's company distributes on behalf of Delta Trak, Inc. are used to verify that a particular temperature range is maintained during shipment. Once the recorder is activated, it is sealed and the doors to the truck, rail car or vessel are closed. At the end of shipment, if the product arrives in an unacceptable condition, the recorder is removed, opened, and the temperature range is read. Packers and shippers use these recorders to

assist in determining liability for damage by establishing whether shipping conditions caused the spoilage.

Given the fact that Ms. Caslin's customers (generally packers and shippers) resell the recorders (to out-of-state retailers) and make no functional use of the recorders, the Board appropriately found her transactions were sales for resale. Therefore, her sales were not taxable.

In addition, the Board determined that tax does not apply to the resale of the recorders by packers and shippers, because they deliver the recorders *out-of-state* which is where the Board determined the first functional use takes place. As such, these subsequent sales are exempt sales in interstate commerce.

What's more, the Board directed staff to publish this opinion - thereby solving this tax problem for all similarly situated taxpayers.

Congratulations to Ms. Caslin on her hard-fought victory! Her patience and perseverance resulted in a decision having significant tax implications for everyone involved in California's agriculture industry.



**Congratulations
Susan Lorie Caslin on
your hard-fought victory!**

**Comments, suggestions and ideas?
Please send them to:**

**Board of Equalization, Second District
7540 Shoreline Drive, Suite D
Stockton, CA 95219**

**PH: 209.473.6579 FAX 209.473.6584
E-mail dsotelo@boe.ca.gov**

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